



Know the Earth...Show the Way

NGA Case Study

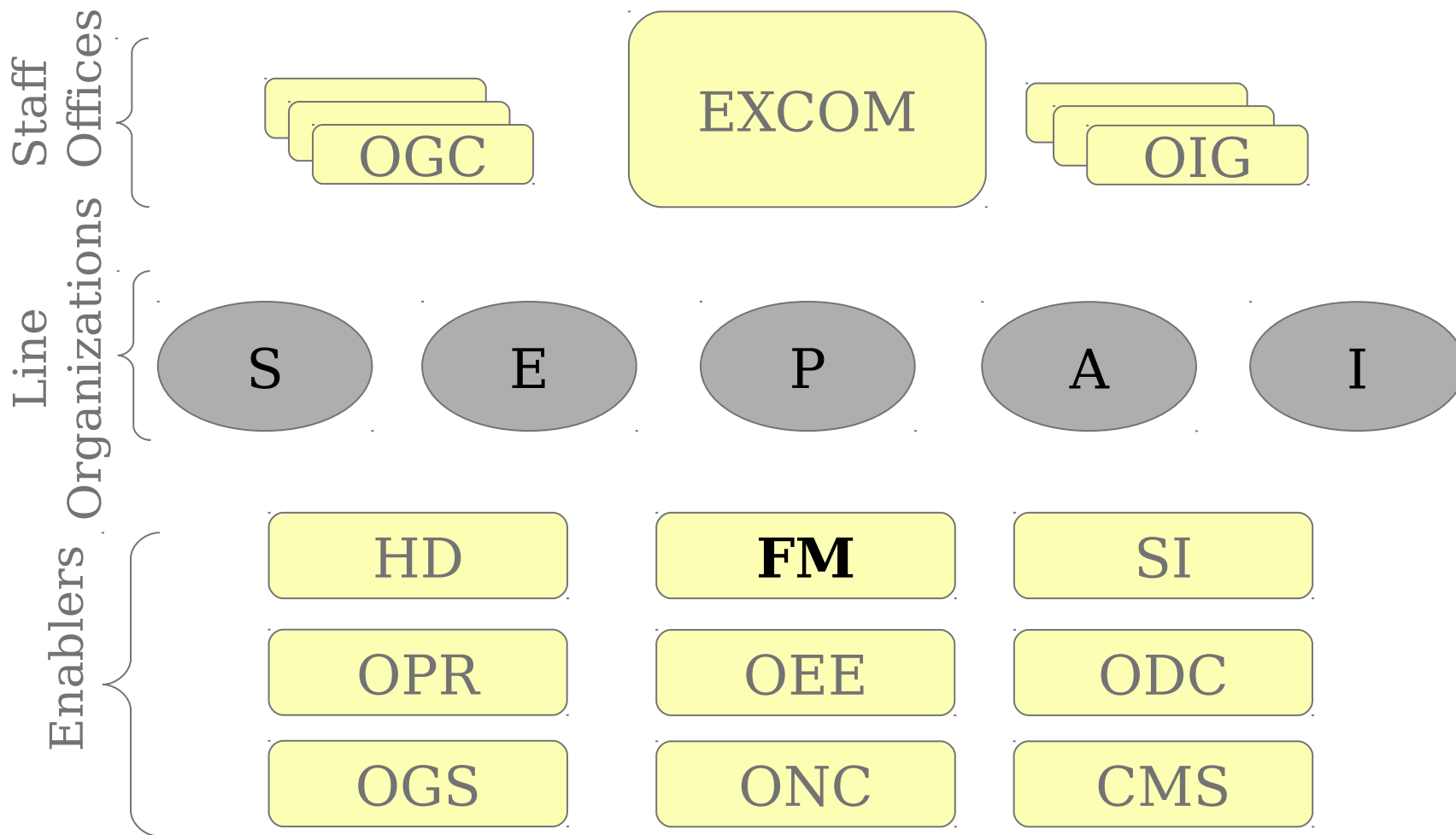
Internal Controls Over Financial Reporting
27 January 2005

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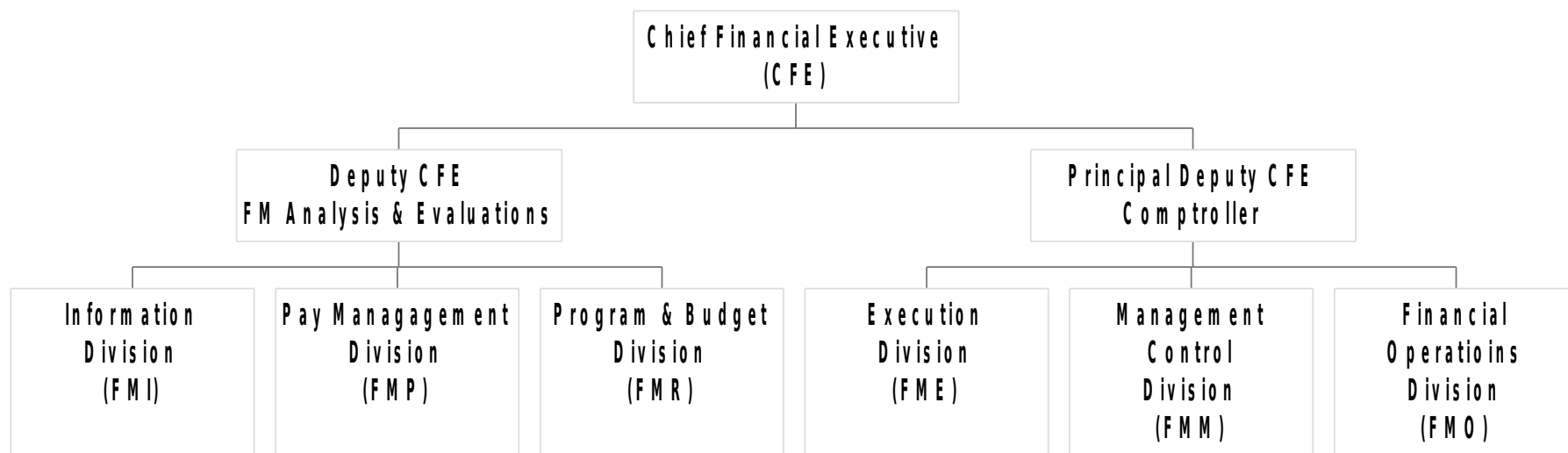
► **Overview**

- Introduction
- NGA / FMO Organization
- Background (Original Intent)
- OMB Circular A-123 Process
- NGA/FMO Focus: Evaluating Internal Control at the Process, Transaction or Application Level
- Accounts Receivable Case Study
- Process Results
- Lessons Learned
- Conclusion
- Questions

► Organization



► ***Financial Management (FM)***



► ***Original Intent (background)***

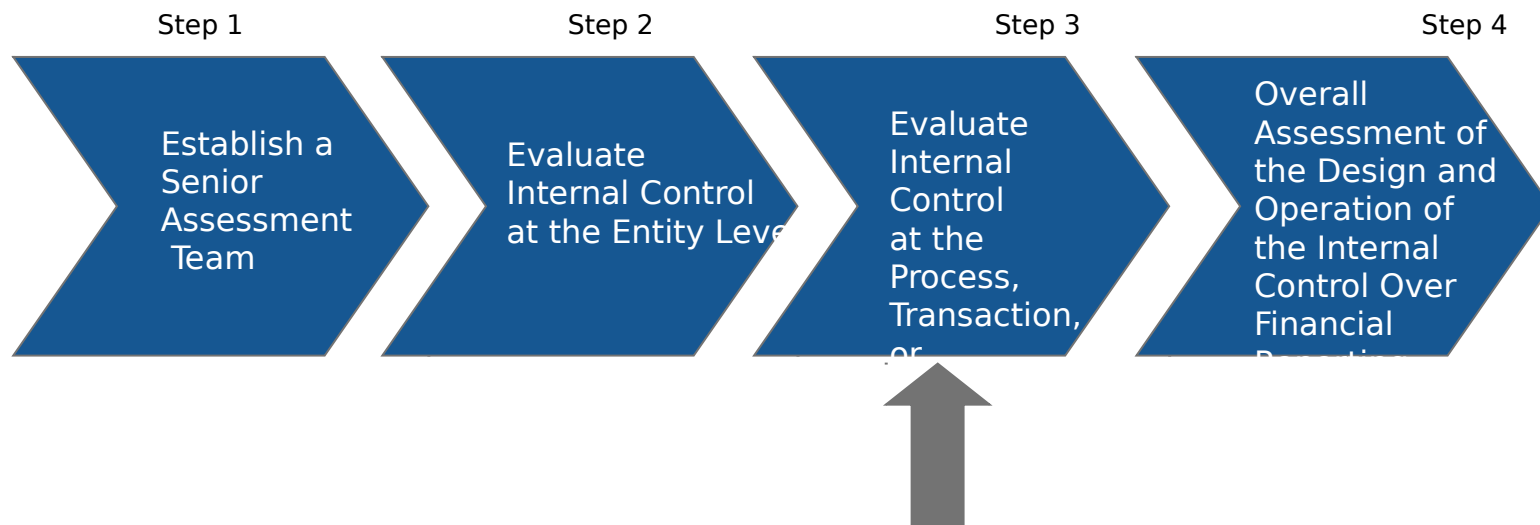
FMO initiated a process to address internal controls at the transaction level to...

- Prepare for FY 2006 audit.
- Document how the major classes of transactions are *initiated, recorded, processed, and reported*.
- Evaluate the effectiveness of internal controls for financial reporting.
- Review existing controls and documentation for completeness to determine whether additional controls were needed.
- Develop and implement solutions to identified weaknesses.
- Integrate internal controls for financial reporting into NGA's Management Control Plan creating additional assessable units.

...and then OMB revised Circular A-123

► ***Internal Controls For Financial Reporting***

- Methodology For Assessing Internal Control Over Financial Reporting (Revised OMB Circular A-123)



- FMO Focus: Evaluating internal control at the process, transaction, or application level.

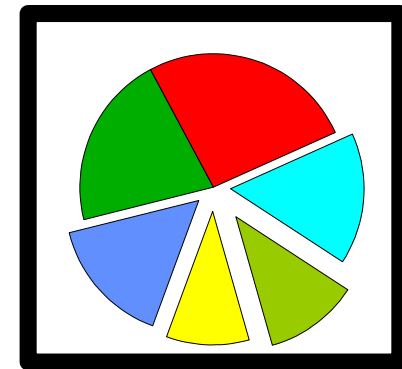
► ***OMB Circular A-123***

Evaluate Internal Control at the Process, Transaction or Application Level:

1. Determine Significant Accounts or Groups of Accounts.
2. Identify and Evaluate the Major Classes of Transactions.
3. Understand the Financial Reporting Process.
4. Gain an Understanding of Control Design to Achieve Management's Assertions.
5. Controls Not Adequately Designed.
6. Test Controls and Assess Compliance to Support Management's Assertions.

► **NGA/FMO Process**

- Evaluating internal control at the process, transaction, or application level – process steps:
 1. Determine the significant accounting applications that provide a source of entries to each line item
 2. Document significant transaction cycles
 3. Assess control risk (Risk Assessment) – determine the types of errors that can occur.
 4. Identify control activities
 5. Evaluate existing controls
 6. Report with action plan for improvements



► *Caveat*

CAUTION

- FMO process alone does not provide OMB Circular A-123 compliance.
 - Senior Assessment Team carries out or directs assessment.
 - Management asserts on adequacy of internal controls for financial reporting.
 - Testing of Controls not formalized.
- FMO process is a way to *prepare* for the assessment
 - Document current processes.
 - Includes identification of problem areas and remediation.

► **1. Determine Significant Accounts or Groups of Accounts**

- Size composition of the account.
- Materiality – “qualitative as well as quantitative”
 - Some accounts or cycles may not be quantitatively material, but require special attention (i.e. *Accounts Receivable*)
- Volume of activity.
- Subjectivity in determining the account balance.
 - Give special attention to components of an account subject to differing risks or controls such as estimation for *Allowance for Doubtful Accounts* or process such as accrual estimation.

► ***1. Determine Significant Accounts or Groups of Accounts***

- NGA Significant Accounts
 - Fund Balance with Treasury (FBWT)
 - Accounts Receivable
 - Property, Plant, and Equipment (PP&E)
 - Personal Property
 - Real Property
 - Internal Use Software
 - Accounts Payable
 - Operating/Program Expenses

► 2. ***Identify and Evaluate the Major Classes of Transactions***

- Identify major classes of transactions that materially affect significant accounts.
- Document how the major classes of transactions are *initiated, recorded, processed, and reported*.
 - Focus on activities where data is initiated, transferred, or changed.
 - Input Sources
 - Important data files, documents, and records
 - Significant processing procedures
 - Output Files
 - Segregation of Duties

► ***2. Identify and Evaluate the Major Classes of Transactions***

- NGA's Major Classes of Transactions
 - Personnel & Payroll
 - Travel
 - Purchases (Inventory & Production)
 - Budget
 - Appropriations Received
 - Budget Execution
 - Financial Reporting Process

► **2. *Identify and Evaluate the Major Classes of Transactions***

- FMO process assesses selective major accounts and then relates accounts to major class of transaction later in the process.
 - Example: Accounts Receivable normally part of the “Sales” Cycle.
 - Better alignment with DoD FMRs and DFAS procedural guidance.
- Financial Reporting Process a separate assessment.
- Case Study Example - *Accounts Receivable*

► 2. **Identify and Evaluate the Major Classes of Transactions - Accounts Receivable**

- Defense Finance and Accounting Service (DFAS) *Concept of Operations for Managing Accounts Receivable*, August 2003.
- Department of Defense (DoD) 7000.14-R, Financial Management Regulation, Volume 4, Chapter 3, *Receivables*.
- Department of Defense (DoD) 7000.14-R, Financial Management Regulation, Volume 4, Chapter 5, *Advances and Prepayments*.
- Department of Defense (DoD) 7000.14-R, Financial Management Regulation, Volume 4, Chapter 28, *General Provisions on Individual Indebtedness*.
- Department of Defense (DoD) 7000.14-R, Financial Management Regulation, Volume 5, Chapter 29, *Collection of Individual Out-Of-Service Debts*.
- Department of Defense (DoD) 7000.14-R, Financial Management Regulation, Volume 8, Chapter 8, *Underpayments and Indebtedness*.
- Department of Defense (DoD) 7000.14-R, Financial Management Regulation, Volume 10, Chapter 18, *Contractor Debt Collection*.
- Office of Management and Budget (OMB) Circular No. A-129, *Policies for Federal Credit Programs and Non-Tax Receivables*.
- NI 2140.1R7, *NGA Instruction for Security Assistance Management*.
- NI 2140.2R4, *NGA Instruction for Nonstandard Foreign Military Sales*.

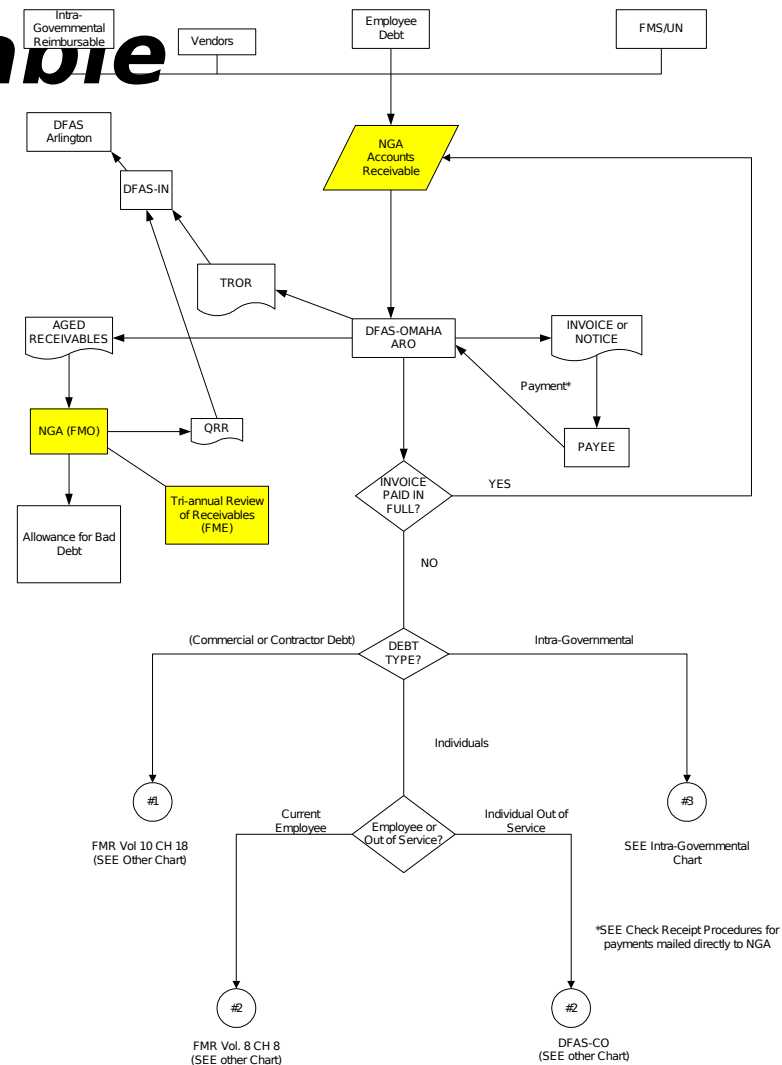
► ***2. Identify and Evaluate the Major Classes of Transactions - Accounts Receivable***

Develop Cycle Memorandum and Flowcharts:

- Accounts Receivable – Overview
- Commercial or Contractor Debt
- Employee Debt
- Foreign Military Sales
- Intra-Governmental Receivables (Reimbursable)

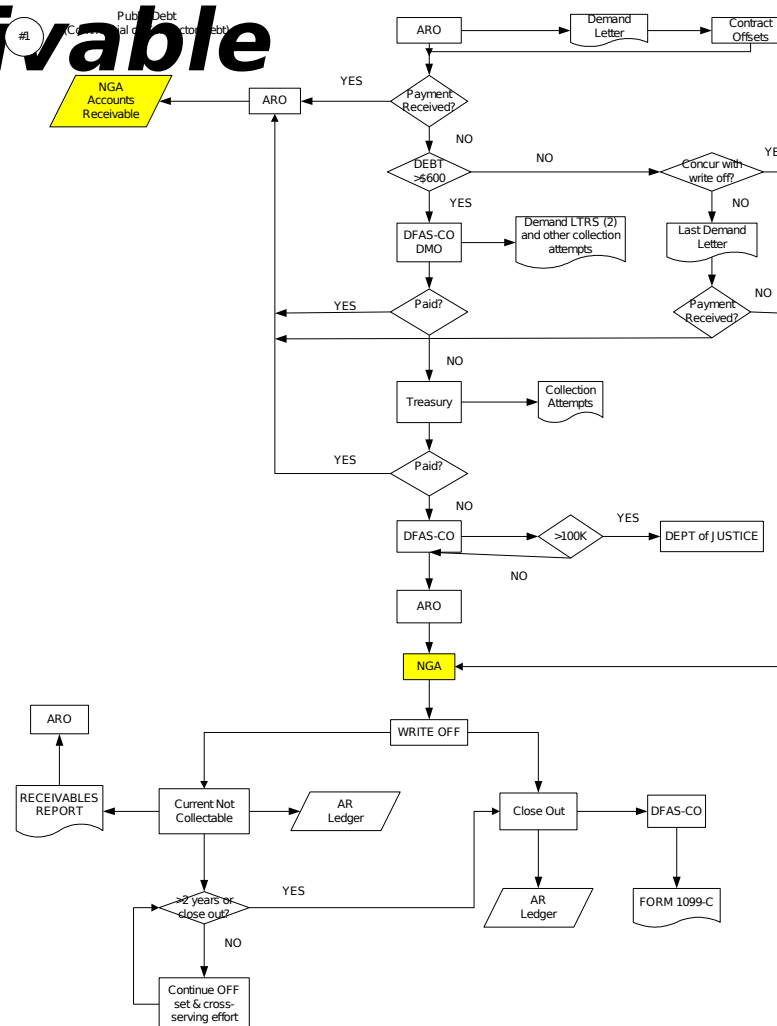
2. Identify and Evaluate the Major Classes of Transactions - Accounts Receivable

Accounts Receivable Overview



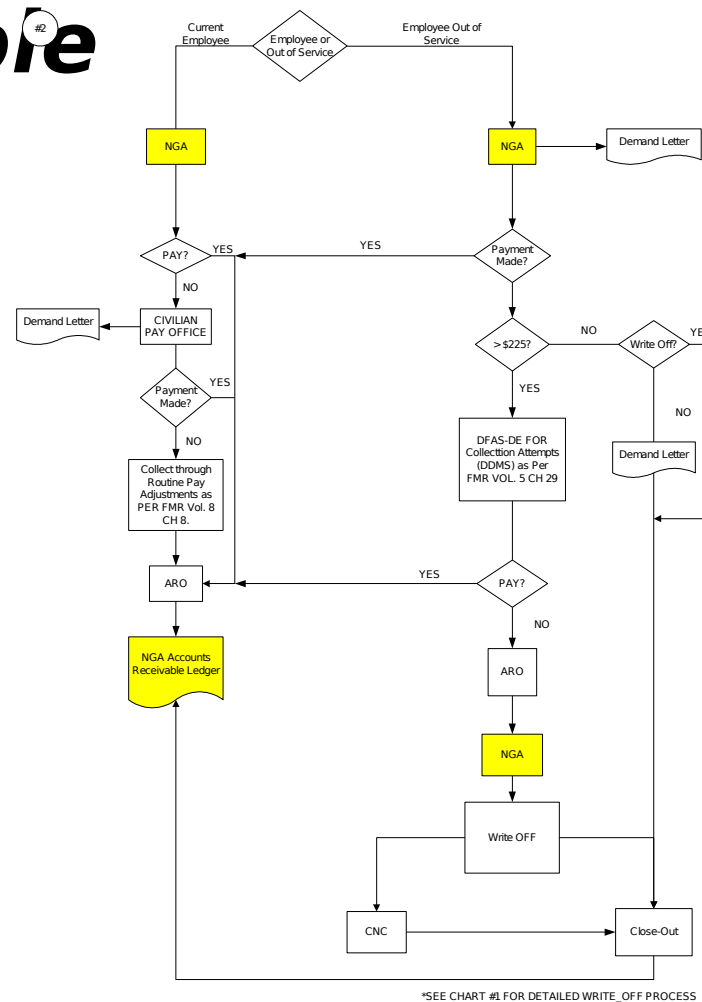
2. Identify and Evaluate the Major Classes of Transactions - Accounts Receivable

Commercial or Contractor Debt



2. Identify and Evaluate the Major Classes of Transactions - Accounts Receivable

Employee
Debt

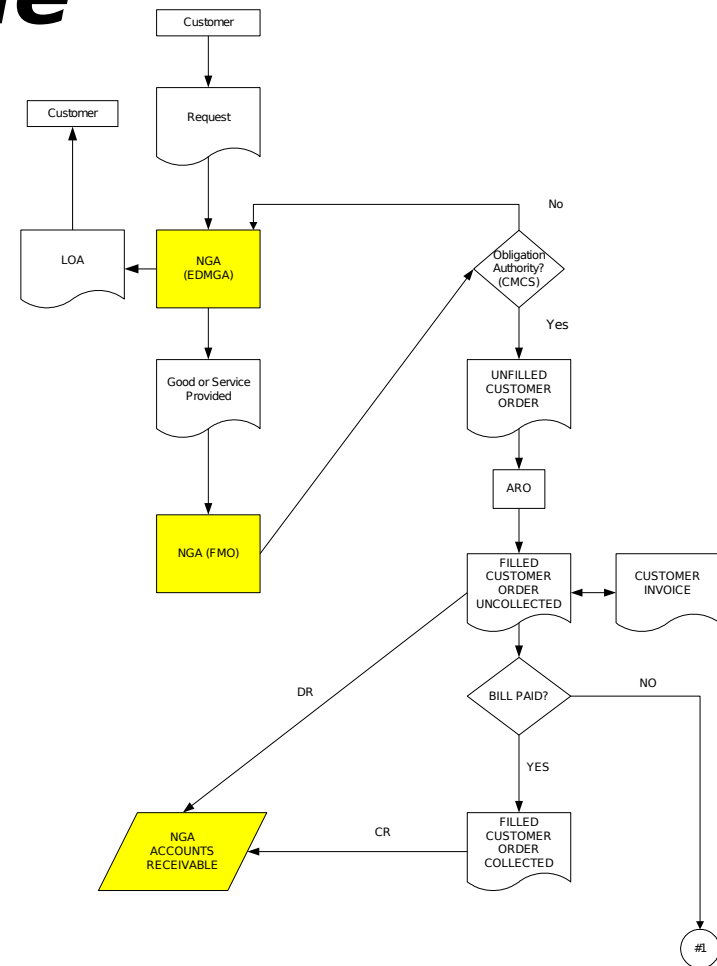


*SEE CHART #1 FOR DETAILED WRITE_OFF PROCESS

2. Identify and Evaluate the Major Classes of Transactions - Accounts Receivable

Standard Foreign Military Sales

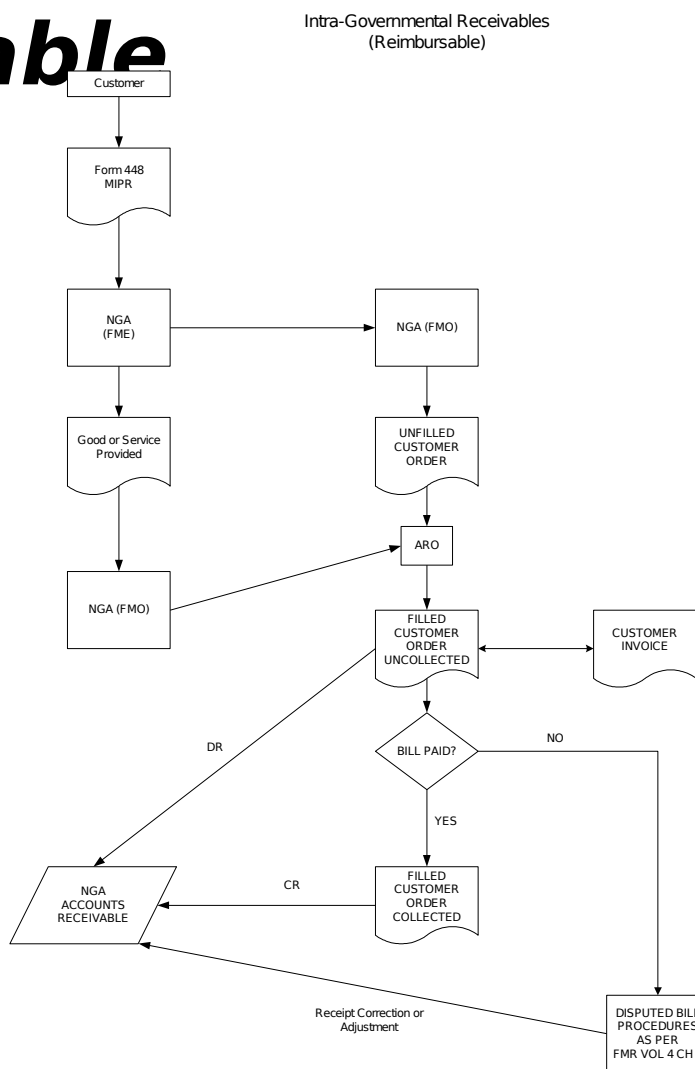
Standard Foreign
Military Sales



20

2. Identify and Evaluate the Major Classes of Transactions - Accounts Receivable

Intra-Governmental
Debt
(Reimbursable)



► ***3. Understand the Financial Reporting Process***

- Separate internal control evaluation (process).
- Focus:
 - Procedures used to enter transaction totals into the general ledger.
 - Procedures used to initiate, record, and process journal entries in the general ledger.
 - Other procedures used to record recurring and nonrecurring adjustments to the financial statements.
 - Procedures for drafting financial statements and related footnote disclosures.
 - Special attention to manual processes.

► **4. *Gain an Understanding of Control Design to Achieve Management's Assertions***

Risk Assessment

- OMB Cir. A-123: "...process on how management considers risks relevant to financial reporting objectives..."
- Auditor: Assessment of the risk of material misstatement in a financial statement.

► **4. Gain an Understanding of Control Design to Achieve Management's Assertions**

- What can go wrong?
- What are the points in the flow where errors can occur?
- Relate to financial statement assertions
 - Existence or Occurrence
 - Valuation
 - Completeness
 - Rights & Obligations
 - Presentation & Disclosure
- Identify points where data is initiated, transferred or changed.
 - Points where controls may be required

► **4. Gain an Understanding of Control Design to Achieve Management's Assertions**

Risk Assessment

- What ensures Accounts Receivable exist at a given date? (*Existence or Occurrence*)
- What ensures we are recording all Accounts Receivable entries? (*Completeness*)
- What ensures Accounts Receivable are recorded at the correct amount? (*Valuation*)

► ***4. Gain an Understanding of Control Design to Achieve Management's Assertions***

Identify and document current internal controls:

- How is the control performed?
- Who performs the control?
- What data is used in performing the control?
- What physical evidence demonstrates the control was performed?

► **4. *Gain an Understanding of Control Design to Achieve Management's Assertions***

Current internal controls:

- ✓ References provide detailed procedural guidance.
- ✓ Write-off authorization with Chief, FMO.
- ✓ Triennial review of receivables.
- ✓ Recorded amounts supported by detailed records.
- ✓ Monthly reimbursable program reconciliation.
- ✓ Adequate segregation of duties.
- ✓ Records stored in highly secured areas.
- ✓ IT process controls.

► **4. Gain an Understanding of Control Design to Achieve Management's Assertions**

- What ensures Accounts Receivable exist at a given date? (*Existence or Occurrence*)
 - Monthly reimbursable program reconciliation.
 - Recorded amounts supported by detailed records.
 - IT Process Controls.
- What ensures we are recording all Accounts Receivable entries? (*Completeness*)
 - Monthly reimbursable program reconciliation.
 - Triennial review of receivables.

► **4. *Gain an Understanding of Control Design to Achieve Management's Assertions***

- Assess the effectiveness of the design of controls
 - Is control suitably designed to prevent or detect a material error?
 - Perform “walk-through” of control.
- Prepare a Specific Control Evaluation (SCE) as per the Financial Audit Manual (FAM)
 - Documents risks.
 - Aids in associating control with risk.
 - Can be used during test of controls.

4. Gain an Understanding of Control Design to Achieve Management's Assertions

ENTITY: National Geospatial Intelligence Agency DATE OF FIN STMTS.: 30 Sep 05 ACCOUNTING APPLICATION: Accounts Receivable		SPECIFIC CONTROL LOCATION: _____ (Line Item/Account-Related)				PREPARER: J. _____ REGION: _____ DATE: 1 NOV 04	
		FILE: SCE Accounts Receivable.doc PAGE 1 of 2					
ACCOUNTING APPLICATION ASSERTIONS	RELEVANT ASSERTIONS IN RELATED GROUPS OF ACCOUNTS	POTENTIAL MISSTATEMENTS IN ACCOUNTING APPLICATION ASSERTIONS	CONTROL OBJECTIVES	INTERNAL CONTROL ACTIVITIES	IS Y/N	EFFECTIVENESS OF CONTROL ACTIVITIES	W/P REF. & CONTROL TESTING PROGRAM STEP
Existence or Occurrence		Substantiation: Recorded assets and liabilities do not exist at a given date.	Recorded accounts receivable should exist at a given date.	FME maintains record of all originating MIPRs. FMO quarterly review of travel-related documents initiating employee debt			
Valuation or Allocation		Valuation: Assets and liabilities included in the financial statements are recorded at incorrect amounts (either understated or overstated).	Receipt transactions must be recorded accurately.	Reconciliation between recorded receipts & FBWT FME Triennial Review FMO A/R SOP			

► **5. Controls Not Adequately Designed**

Action Items

- Development of NGA Accounts Receivable SOP
 - Management Reviews
 - NGA process for estimating allowance for bad debts
 - NGA write-off process and thresholds
 - Accounting entries for receivables using Standard General Ledger Accounts

► **5. Controls Not Adequately Designed**

Action Items

Accounts Receivable



**National Geospatial-Intelligence
Agency (NGA)
Financial Management Directorate
Financial Operations Division (FMO)**

Accounts Receivable Procedure

**FMO Standard Operating Procedure
(SOP) FMO-009
3 December 2004**

Comprehensive A/R SOP including:

- ✓ Management Reviews
- ✓ NGA process for estimating allowance for bad debts
- ✓ NGA write-off process and thresholds
- ✓ Accounting entries for receivables using Standard General Ledger Accounts

► **5. Controls Not Adequately Designed**

Action Items

- Develop and document formal procedures to detect and initiate accounts receivable transactions for contractor debt and employee related debt (addressed during travel, payroll, and purchases)
- Request from service provider (DFAS)
 - Aged receivables as per DFAS CONOPS
 - Assume duties of preparing Quarterly Report on Receivables (QRR)
 - Independent audit report in accordance with Statement of Auditing Standards (SAS) 70 providing assurance regarding service organization's controls.

► **6. *Test Controls and Assess Compliance to Support Management's Assertions***

- "...the senior assessment team should test those controls to determine the extent to which the controls were applied, the consistency of their application, and who applied them."
- Perform after all account and cycle assessments complete.
 - FMO plan recommends internal audit perform test of controls.
 - Use SCE to plan test of controls.
 - Develop a robust control self-assessment process.

► ***Internal Controls For Financial Reporting***

Internal Control Documentation for each accounting cycle

- Internal Controls Summary
 - Identifies Internal Control Activities
 - Assessment of Control Activities
- Recommendations / Action Items
 - Identifies additional control activities (if needed)
 - SOPs and or NI revisions
- Specific Control Evaluation
 - Identifies potential misstatements, control activities, and control objectives
 - Framework for test of controls (FAM)
- Cycle Memorandum/Flowchart
- References
 - FMR, DFAS, NGA Instructions



► ***Process Results***

Two assessments under review

- Accounts Receivable
 - FMO Accounts Receivable SOP
 - DFAS procedural improvements
 - Focus on process improvements during travel and payroll assessments
- PP&E Personal Property
 - FMO Personal Property SOP
 - Various other SOPs (lease capitalization, acquisition cost estimation, inventory procedures)
 - DPAS reconciliation procedure
 - Identification of potential problem areas
 - Vehicle to address concerns and issues outside of FM (documented and evidential)

► ***Process Status***

Two assessments under review:

- Accounts Receivable
- PP&E Personal Property

Three assessments ongoing:

- Travel
- Personnel and Payroll
- PP&E Real Property

Scheduled next:

- Fund Balance with Treasury

► ***Lessons Learned***

- Initiate documentation and assessment of internal control at the process, transaction or application level early-on.
 - Documenting and evaluating controls at this level is far more specific and will require significantly more time to complete.
 - Remediation effort is time intensive.
 - Writing and staffing SOPs.
 - Developing and implementing new processes.
 - Conducting inventories and other time consuming activities.
- Prioritize work to address known problem areas.

Internal Control Documentation and Assessment at the Transaction



NGA / FMO Internal Control Assessment

- ✓ By Major Account or Accounting Cycle
- ✓ Identifies and documents control activities
- ✓ Auditable
- ✓ Corrects identified deficiencies
- ✓ Provides for test of controls
- ✓ Preparation for Senior Assessment Team

RESULT

*OMB Cir. A-123
Compliance*

Internal Control Documentation and Assessment at the Transaction Level

...but more importantly.



*Unqualified
Audit
Opinion*

Questions?

NATIONAL GEOSPATIAL-INTELLIGENCE AGENCY



» *Know the Earth...Show the Way* »» »